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SUBJECT: 2009 INVESTMENT CLIMATE STATEMENT - MEXICO

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Openness to Foreign Investment

¶1. Mexico is open to foreign direct investment (FDI) in most economic sectors and has consistently been one of the largest recipients of FDI among emerging markets. In recent years, Mexico has become increasingly aware of its loss of competitiveness relative to other emerging economies, notably China and India, as it had failed to address serious crime and safety issues or pass much needed reforms. Recent government successes in the reform agenda have improved business confidence, underpinning increases in foreign investment. Mexico has significantly increased the tempo of efforts against organized crime, but rising narcotics-related violence remains a cause for concern. Mexico will need progress on both fronts to regain competitiveness as an FDI destination, particularly for non-U.S. investors. The current international economic downturn adds to the challenge, as FDI grows scarcer and investors more cautious.

¶2. Foreign investment in Mexico has largely been concentrated in the northern states close to the U.S. border where most maquiladoras are located, and in the Federal District (Mexico City) and surrounding states. The Yucatan peninsula, historically an area for tourism investment, has seen industry in other sectors grow due in part to the ability to quickly send goods from its ports to the United States. Financial services, automotive and electronics have received the largest amounts of FDI. Historically, the United States has been the largest source of FDI in Mexico. U.S. investors provided 39 percent of FDI in 2007.

¶3. In June 2007, President Calderon created ProMexico, a federal entity charged with promoting Mexican exports around the world and attracting foreign direct investment to Mexico. Through ProMexico, federal and state government efforts, as well as related private sector activities, are coordinated with a goal of harmonizing programs, strategies and resources aimed at common objectives and priorities while supporting the globalization of Mexico's economy. ProMexico maintains an extensive network of offices abroad as well as a multi-lingual website (http://www.investinmexico.com.mx) which provides information on establishing a corporation, rules of origin, labor issues, owning real estate in Mexico, the maquiladora industry, and sectoral promotion plans, among other topics. ProMexico will coordinate Mexico's hosting of the 2010 World Conference of Trade Promotion Agencies in Riviera Nayarit.

¶4. The Secretariat of Economy (SECON) also maintains a bilingual website (www.economia.gob.mx) offering an array of information, forms, links and transactions. Among other options, interested parties can download import/export permit applications, make on-line tax payments, and chat with on-line advisors who can answer specific investment and trade related questions. State governments have also passed small business facilitation measures to make it easier to

open businesses.

¶5. Despite progress however, it takes on average 28 days to complete all paperwork required to start a business in Mexico, against an average OECD figure of 13.4 days, according to a World Bank study. The Embassy advises potential investors to contact ProMexico for detailed information on investing in Mexico.

¶6. The 1993 Foreign Investment Law is the basic statute governing foreign investment in Mexico. The law is consistent with the foreign investment chapter of NAFTA (the North American Free Trade Agreement). It provides national (i.e. non-discriminatory) treatment for most foreign investment, eliminates performance requirements for most foreign investment projects, and liberalizes criteria for automatic approval of foreign investment.

¶7. The Foreign Investment Law identifies 704 activities, 656 of which are open for 100 percent FDI stakes. There are 18 activities in which foreigners may only invest 49 percent; 13 of which require Foreign Investment National Commission approval for a 100 percent stake; 5 reserved for Mexican nationals; and 10 reserved for the Mexican state. Below is a summary of activities subject to investment restrictions.

SECTION 1: SECTORS RESERVED FOR THE STATE IN WHOLE OR IN PART:

A) Petroleum and other hydrocarbons;
B) Basic petrochemicals;
C) Telegraphic and radio telegraphic services;
D) Radioactive materials;
E) Electric power generation, transmission, and distribution;
F) Nuclear energy;

G) Coinage and printing of money;
H) Postal service;
I) Airports;
J) Control, supervision and surveillance of ports and heliports.

SECTION 2: SECTORS RESERVED FOR MEXICAN NATIONALS:

A) Retail sales of gasoline and liquid petroleum gas;
B) Non-cable radio and television services;
C) Credit Unions, Savings and Loan Institutions, and Development Banks;
D) Certain professional and technical services;
E) Domestic transportation for passengers, tourism and freight, except for messenger or package delivery services.

¶8. U.S. and Canadian investors generally receive national and most-favored-nation treatment in setting up operations or acquiring firms. Exceptions exist for investments for which the Government of Mexico recorded its intent in NAFTA to restrict certain industries to Mexican nationals. U.S. and Canadian companies have the right under NAFTA to international arbitration and the right to transfer funds without restrictions. NAFTA also eliminated some barriers to investment in Mexico, such as trade balancing and domestic content requirements. Local governments must also accord national treatment to investors from NAFTA countries. Mexico is also a party to several OECD agreements covering foreign investment, notably the Code of Liberalization of Capital Movements and the National Treatment Instrument.

¶9. Approximately 95 percent of all foreign investment transactions do not require government approval. Foreign investments requiring applications and not exceeding USD 165 million are automatically approved, unless the proposed investment is in a sector subject to restrictions by the Mexican constitution and Foreign Investment Law that reserve certain sectors for the state and Mexican nationals (see Table 1). The National Foreign Investment Commission determines whether investments in restricted sectors may go forward and has 45 working days to make a decision. Criteria for approval include employment and training considerations, technological contributions, and contributions to productivity and competitiveness. The Commission may reject applications to acquire Mexican companies for national security reasons. The Secretariat of Foreign Relations

(SRE) must issue a permit for foreigners to establish or change the nature of Mexican companies.

¶10. Despite Mexico's relatively open economy, a number of key sectors in Mexico continue to be characterized by a high degree of market concentration. For example, the telecommunications, electricity, television broadcasting, petroleum, beer, and tortilla sectors feature one or two or several dominant companies (some private, others public) with enough market power to restrict competition. The Mexican Congress strengthened the enforcement powers of the Federal Competition Commission (CFC) in 2006 and is considering stiffer penalties for anti-competitive conduct, but the CFC remains weak relative to its OECD counterparts in terms of enforcement. CFC Commissioner Eduardo Perez Motta and leading members of the Calderon Administration, including the President, have publicly committed to opening up the Mexican economy to greater competition. For more information on competition issues in Mexico visit CFC's bilingual website at: www.cfc.gob.mx.

¶11. ENERGY: The Mexican constitution reserves ownership of petroleum and other hydrocarbon reserves for the Mexican state. The energy reform package approved by the Mexican Congress October 2008 did not address this prohibition, and oil and gas exploration and production efforts remain under the sole purview of Pemex, Mexico's petroleum parastatal. The constitution also provides that most electricity service may only be supplied by two state-owned companies, the Federal Electricity Commission (CFE) and Central Power and Light (LYFC). There has been some opening to private capital. Private electric co-generation and self-supply are now allowed. Private investors may build independent power projects but all of their output must be sold to CFE in wholesale transactions. Private construction of generation for export is permitted. In 1995, amendments to the Petroleum Law opened transportation, storage, marketing and distribution of natural gas imports and issued open access regulations for Pemex's natural gas transportation network. Retail distribution of Mexico's natural gas is open to private investment, as is the secondary petrochemical industry. Since the government's announcement in August 2001 that national and foreign private firms will be able to import liquefied petroleum gas duty-free, LNG terminals in Tamaulipas state and Baja California have begun operations, and CFE plans to build a third in Manzanillo, on Mexico's Pacific Coast.

¶12. Finance Public Works Contracts (COPFs), formerly Multiple

Service Contracts (MSCs) designed to comply with the country's constitution, mark Mexico's most ambitious effort to attract private companies to stimulate natural gas production by developing non-associated natural gas fields. Under a COPF contract, private companies will be responsible for 100 percent of the financing of a contract and will be paid for the work performed and services rendered. However, the natural gas produced in a specific field remains the property of Pemex. Examples of work that contractors can perform include seismic processing and interpretation, geological modeling, fields engineering, production engineering, drilling, facility design and construction, facility and well maintenance, and natural gas transportation services. Some Mexican politicians still oppose COPFs as a violation of the Mexican constitution's ban on concessions. Some contracts have failed to attract any bids, demonstrating the limited success of COPFs.

¶13. TELECOMMUNICATIONS: Mexico allows up to 49 percent FDI in companies that provide fixed telecommunications networks and services. This includes the Cable TV (CATV) industry, with one exception: companies can issue Neutral or "N" stocks up to 99 percent, which can be owned by a foreign company. In fact, one CATV company operates under this ownership scheme. There is no limit on FDI in companies providing cellular/wireless services. However, Telmex and Telcel (Amrica Msvil) continue to reign as the dominant telecom fixed and wireless powers and wield significant influence over key regulatory and government decision makers. Mexico's dominant landline and wireless carriers are traded on the New York Stock Exchange. An initiative is currently in the Congress that would completely open fixed telephony to FDI.

¶14. Several large U.S. and international telecom companies are active in Mexico, partnering with Mexican companies or holding minority shares. Following a 2004 WTO ruling, international resellers are authorized to operate in Mexico and some companies are also looking to sell wholesale minutes to resellers. Telcel (technically independent, but majority owned by Telmex owner's Grupo Carso - Carso Global Telecom) still retains a majority share (about 75 percent) of the cellular market. However, Spain's Telefonica Movistar, among others, continues to grow and challenge the status quo. They have deployed extensive mobile infrastructure to increase coverage across the country.

¶15. Telmex continues to dominate the market in Long Distance (domestic and international), Internet access through DSL, and bundle services. The Convergence Accord, published in October 2006, allowed Telmex to offer broadcasting or TV services. However, the Federal Telecommunications Commission ruled that Telmex must first comply with interconnection, interoperability and number portability requirements before receiving permission to complete its triple-play offering. The accord has elicited strong concerns from the CATV industry, which fears that it will push CATV operators to consolidate. Under the accord, CATV operators (including TV duopolist Televisa's Cablevision) are allowed to independently offer Triple Play Service (VoIP-Telephony, Data-Internet and TV-Video), which might increase competition in the telephony market.

¶16. As in telecommunications, there are concerns that the two dominant television companies -- Televisa and TV Azteca, who share duopoly status in the sector -- continue to exercise influence over Mexican judicial, legislative and regulatory bodies to prevent competition. However, in August 2007 the Mexican Supreme Court ruled against the most blatant anti-competition measures of the April 2006 Radio and Television Law. Among other decisions, the Court ruled that it was unfair for broadcasting companies to keep and use at no cost analog spectrum freed from the digitalization process. Currently the Mexican Legislature is working on a new media law based on the Supreme Court's ruling.

¶17. U.S. firms remain unable to penetrate the Mexican television broadcast market, despite the fact that both Televisa and TV Azteca benefit from access to the U.S. market.

¶18. REAL ESTATE: Investment restrictions still prohibit foreigners from acquiring title to residential real estate in so-called "restricted zones" within 50 kilometers (approximately 30 miles) of the nation's coast and 100 kilometers (approximately 60 miles) of the borders. In all, the restricted zones total about 40 percent of Mexico's territory. Nevertheless, foreigners may acquire the effective use of residential property in the restricted zones through the establishment of a 50-year extendible trust (called a fideicomiso) arranged through a Mexican financial institution that acts as trustee.

¶19. Under a fideicomiso the foreign investor obtains all rights of use of the property, including the right to develop, sell and transfer the property. Real estate investors should, however, be

careful in performing due diligence to ensure that there are no other claimants to the property being purchased. Fideicomiso arrangements have led to legal challenges in some cases. U.S. issued title insurance is available in Mexico and a few major U.S. title insurers have begun operations here. Additionally, U.S. lending institutions have begun issuing mortgages to U.S. citizens purchasing real estate in Mexico.

¶20. TRANSPORT: The Mexican government allows up to 49 percent foreign ownership of 50-year concessions to operate parts of the railroad system, renewable for a second 50-year period. The Mexican Foreign Investment Commission and the Mexican Federal Competition Commission (CFC) must approve ownership above 49 percent. In a positive sign for competition, the CFC recently struck down a proposed merger between two of the three major railroad companies. The decision has been appealed. Consistent with NAFTA, foreign investors from the U.S. and Canada are now permitted to own up to 100 percent of local trucking and bus companies, however, several

companies have encountered long wait times and legal tie-ups when trying to obtain permits.

¶21. CINTRA, the government holding company for the Mexican airline groups, Mexicana and Aeromexico, sold Grupo Mexicana to Grupo Posadas in December 2005. Grupo Aeromexico was sold to a consortium led by Citibank-owned Banamex in October 2007. The emergence of low-cost domestic airlines such as Volaris, Click Mexicana, and Interjet have increased competition and led to lower prices. However, foreign ownership of Mexican airlines remains capped at 25 percent. Foreign ownership in airports is limited to 49 percent. Foreign express delivery service companies continue to complain that Mexican legislation unfairly favors Mexican companies by restricting the size of trucks international carriers are allowed to use.

¶22. INFRASTRUCTURE: Mexican infrastructure investment, with certain previously noted exceptions, is open to foreign investment. The Mexican government has been actively seeking an increase in private involvement in infrastructure development in numerous sectors, including transport, communications, and environment. Improvement in the national infrastructure is seen as a key element in strengthening economic competitiveness and attracting investment to disadvantaged regions of the country. In July 2007, President Calderon presented the National Infrastructure Program 2007-2012 a key aspect of which is an increase in private investment through means of Service Lending Projects (public-private partnerships) and concessionary schemes. In October 2008 and January 2009 discourses, President Calderon underlined his commitment to the National Infrastructure Program as a countercyclical tool in the face of a slowing economy. The Office of the President provides an English language copy of the plan at: www.infraestructura.gob.mx.

Conversion and Transfer Policies

¶23. Mexico has open conversion and transfer policies as a result of its membership in NAFTA and the OECD. In general, capital and investment transactions, remittance of profits, dividends, royalties, technical service fees, and travel expenses are handled at market-determined exchange rates. Peso/dollar foreign exchange is available on same-day, 24- and 48-hour settlement bases. Most large foreign exchange transactions are settled in 48 hours. In June 2003, the U.S. Federal Reserve Bank and the Bank of Mexico announced the establishment of an automated clearinghouse for cross-border financial transactions. The International Electronic Funds Transfer System (TEFI) began operating in 2004 and commissions on transfers through the system have dropped rapidly.

Expropriation and Compensation

¶24. Under NAFTA, Mexico may not expropriate property, except for a public purpose and on a non-discriminatory basis. Expropriations are governed by international law, and require rapid fair market value compensation, including accrued interest. Investors have the right to international arbitration for violations of this or any other rights included in the investment chapter of NAFTA.

¶25. There have been twelve arbitration cases, of which two are still pending, filed against Mexico by U.S. and Canadian investors who allege expropriation, and other violations of Mexico's NAFTA obligations. Details of the cases can be found at the Department of State Website, Office of the Legal Advisor (www.state.gov/s/l).

Dispute Settlement

¶26. Chapter Eleven of NAFTA contains provisions designed to protect

cross-border investors and facilitate the settlement of investment disputes. For example, each NAFTA Party must accord investors from the other NAFTA Parties national treatment and may not expropriate investments of those investors except in accordance with international law.

¶27. Chapter Eleven permits an investor of one NAFTA Party to seek money damages for measures of one of the other NAFTA Parties that allegedly violate those and other provisions of Chapter Eleven. Investors may initiate arbitration against the NAFTA Party under the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL Rules") or the Arbitration (Additional Facility) Rules of the International Center for Settlement of Investment Disputes ("ICSID Additional Facility Rules"). Alternatively, a NAFTA investor may choose to use the registering country's court system.

¶28. The Mexican government and courts recognize and enforce arbitral awards. The Embassy has heard of no actions taken in the Mexican courts for an alleged Chapter 11 violation on behalf of U.S. or Canadian firms.

¶29. There have been numerous cases in which foreign investors, particularly in real estate transactions, have spent years dealing with Mexican courts trying to resolve their disputes. Often real estate disputes occur in popular tourist areas such as the Yucatan. American investors should understand that under Mexican law many commercial disputes that would be treated as civil cases in the U.S. could also be treated as criminal proceedings in Mexico. Based upon the evidence presented a judge may decide to issue arrest warrants. In such cases Mexican law also provides for a judicial official to issue an "amparo" (injunction) to shield defendants from arrest. U.S. investors involved in commercial disputes should therefore obtain competent Mexican legal counsel, and inform the U.S. Embassy if arrest warrants are issued.

Performance Requirements and Incentives

¶30. The 1993 Foreign Investment Law eliminated export requirements (except for maquiladora industries), capital controls, and domestic content percentages, which are prohibited under NAFTA. Foreign investors already in Mexico at the time the law became effective could apply for cancellation of prior commitments. Foreign investors who failed to apply for the revocation of existing performance requirements remained subject to them.

¶31. The Mexican federal government has eliminated direct tax incentives, with the exception of accelerated depreciation. A fiscal reform package was passed in September 2007 that includes a Flat Rate Corporate Tax (IETU). This tax limits the deductions that companies are allowed, though changes made at the behest of the business community still allow some credits for previous inventories and investments, as well as for companies that fall under the maquiladora scheme. In 2009, the IETU will increase from 16.5% to 17%, and to 17.5% in 2010. Investors should follow IETU developments closely.

¶32. Most taxes in Mexico are federal; therefore, states have limited opportunity to offer tax incentives. However, Mexican states have begun competing aggressively with each other for investments, and most have development programs for attracting industry. These include reduced price (or even free) real estate, employee training programs, and reductions of the 2 percent state payroll tax, as well as real estate, land transfer, and deed registration taxes, and even new infrastructure, such as roads. Four northern states -- Nuevo Leon, Coahuila, Chihuahua and Tamaulipas -- have signed an agreement with the state of Texas to facilitate regional economic development and integration. Investors should consult the Finance, Economy, and Environment Secretariats, as well as state development agencies, for more information on fiscal incentives. Tax attorneys and industrial real estate firms can also be good sources of information.

¶33. U.S. Consulates have reported that the states in their consular districts have had to modify their incentive packages due to government decentralization. Many states have also developed unique industrial development policies. Sonora, for example, is working to expand the free entry area for tourists (south from the border to the port of Guaymas.) Sonora is one state that has implemented long-term agriculture and infrastructure development plans. The government of Yucatan provides information and support to potential investors and business entrepreneurs through several programs that target different industries such as technology, agroindustry and energy exploration. Several states are competing to attract

manufacturing in the aerospace industry.

¶34. A government-owned development bank, Nacional Financiera, S.A. (www.nafin.com), provides loans to companies in priority development areas and industries. It is active in promoting joint Mexican-foreign ventures for the production of capital goods. Nacional Financiera offers preferential, fixed-rated financing for the following types of activities: small and medium businesses; environmental improvements; studies and consulting assistance; technological development; infrastructure; modernization; and capital contribution. The Mexican Bank for Foreign Trade, Bancomext, offers a variety of export financing and promotion programs (www.bancomext.com).

¶35. Mexico's maquiladora and PITEX (Program for Temporary Imports to produce Exports) programs aim to stimulate manufactured exports and operate in largely the same manner. The first focuses on companies that specialize in in-bond manufacturing and export, while the second is for companies that may have significant domestic sales. In November 2006, the maquiladora and PITEX programs were combined into the renamed IMMEX (Industria Manufacturerera, Maquiladora y Servicios de Exportacion) program. The IMMEX program adds services, such as business process outsourcing, to the maquila scheme and also simplifies and streamlines the processes under the two previous schemes. The new program continued to exempt companies from import duties and applicable taxes (e.g. VAT) on inputs and components incorporated into exported manufactured goods. In addition, capital goods and the machinery used in the production process are tax exempt, but are currently subject to import duties. Companies interested in investing in industrial activity in Mexico need to follow the new IMMEX guidelines closely, preferably in close consultation with locally based legal advisors. Two export programs implemented during the 1990s, ALTEX (Empresas Altamente Exportadoras) and ECEX (Empresas de Comercio Exterior), also allow expedited VAT returns and financing from government-owned development banks. Please refer to the Secretariat of Economy's IMMEX program website at http://www.economia.gob.mx/?P=immex.

¶36. In order to maintain competitiveness of maquiladora and PITEX companies and comply with NAFTA provisions, since 2001 Mexico has applied "Sectoral Promotion Programs" (PROSEC). Under these programs, most favored nation import duties on listed inputs and components used to produce specific products are eliminated, or reduced to a competitive level. These programs comply with NAFTA provisions because import duty reduction is available to all producers, whether the final product is sold domestically or is exported to a NAFTA country. Currently PROSECs support 22 sectors, including electronics and home appliances, automotive and auto-parts, textile and apparel, footwear, and others. The lists of inputs and components incorporated under each PROSEC are not exhaustive, and the Mexican government regularly consults with industries to include more goods. In December 2008, President Calderon issued in the Official Gazette (Diario Oficial) an immediate and gradual reduction of import duties in order for companies to obtain inputs at competitive prices.

¶37. In the last four years the Secretariat of Economy conducted, in partnership with the private sector, 12 studies of the country's most important sectors according to their levels of exports, employment and FDI, called "Programs for Sectoral Competitiveness." These studies are currently available at the website of the Secretariat of Economy (http://www.economia.gob.mx/?P=944).

Right to Private Ownership and Establishment

¶38. Foreign and domestic private entities are permitted to establish and own business enterprises and engage in all forms of remunerative activity in Mexico, except those enumerated in Section 1 Table 1. Private enterprises are able to freely establish, acquire and dispose of interests in business enterprises. The two most common types of business entities are corporations (Sociedad Anonima) and limited partnerships (Sociedad de Responsibilidad Limitada). Under these legal entities a foreign company may operate an independent

company, a branch, affiliate, or subsidiary company in Mexico. The rules and regulations for starting an enterprise differ for each structure.

CORPORATION (SOCIEDAD ANONIMA):

A) Can be up to 100 percent foreign-owned;
B) Must have a minimum of 50,000 Mexican pesos in capital stock to start;
C) Must have minimum of 2 shareholders, with no maximum. Board of Directors can run the administration of the company;
D) The enterprise has an indefinite life span;
E) Free transferability of stock ownership is permitted;
F) Operational losses incurred by the Mexican entity or subsidiary

may not be used by the U.S. parent company;
G) Limited liability to shareholders.

LIMITED LIABILITY COMPANY (SOCIEDAD DE RESPONSIBILIDAD LIMITADA):

A) Can be up to 100 percent foreign-owned;
B) Must have a minimum of 3,000 Mexican pesos in capital stock to start;
C) Must have a minimum of 2 partners to incorporate a corporation with limited liability. The partners must manage the company;
D) Exists only while there is a business purpose and partners remain the same;
E) Restricted transferability of partnership shares. Any changes in the partnership composition may cause the partnership to be liquidated;
F) If structured properly, it may offer tax advantages by allowing operational losses incurred by the Mexican entity to be used by the U.S. parent company;
G) Limited liability is afforded the partners.

Protection of Property Rights

¶39. Two different laws provide the core legal basis for protection of intellectual property rights (IPR) in Mexico -- the Industrial Property Law (Ley de Propiedad Industrial) and the Federal Copyright Law (Ley Federal del Derecho de Autor). Multiple federal agencies are responsible for various aspects of IPR protection in Mexico. The Office of the Attorney General (Procuradura General de la Republica, or PGR) has a specialized unit that pursues criminal IPR investigations. The Mexican Institute of Industrial Property (Instituto Mexicano de la Propiedad Industrial, or IMPI) administers Mexico's trademark and patent registries and is responsible for handling administrative cases of IPR infringement. The National Institute of Author Rights (Instituto Nacional del Derecho de Autor) administers Mexico's copyright register and also provides legal advice and mediation services to copyright owners who believe their rights have been infringed. The Mexican Customs Service (Aduana Mxico) plays a key role in ensuring that illegal goods do not cross Mexico's borders.

¶40. Despite strengthened enforcement efforts by Mexico's federal authorities over the past several years, weak penalties and other obstacles to effective IPR protection have failed to deter the rampant piracy and counterfeiting found throughout the country. The U.S. Government continues to work with its Mexican counterparts to improve the business climate for owners of intellectual property.

¶41. Mexico is a signatory of at least fifteen international treaties, including the Paris Convention for the Protection of Industrial Property, the NAFTA, and the WTO Agreement on Trade-related Aspects of Intellectual Property Rights. Though Mexico signed the Patent Cooperation Treaty in Geneva, Switzerland in 1994, which allows for simplified patent registration procedure when applying for patents in more than one country at the same time, it is necessary to register any patent or trademark in Mexico in order to claim an exclusive right to any given product. A prior registration in the United States does not guarantee its exclusivity and proper use in Mexico, but serves merely as support for the authenticity of any claim you might make, should you take legal

action in Mexico.

¶42. An English-language overview of Mexico's IPR regime can be found on the WIPO website at: http://www.wipo.int/about-ip/en/ipworldwide/pdf/mx.pdf.

¶43. Although a firm or individual may apply directly, most foreign firms hire local law firms specializing in intellectual property. The U.S. Embassy's Commercial Section maintains a list of such law firms in Mexico at: http://www.buyusa.gov/mexico/en/business_service_providers.html.

Transparency of Regulatory System

¶44. The Federal Commission on Regulatory Improvement (COFEMER) under the management of the Secretariat of Economy is the agency responsible for reducing the regulatory burden on business. The Mexican government has made progress in the last few years. On a quarterly basis, these agencies must report to the Presidency on progress achieved toward Presidential goals for reducing the regulatory burden. In December 2006, President Calderon replaced the Regulatory Moratorium Agreement, issued by the previous administration to ensure agencies streamline their regulatory promulgation processes, with the Quality Regulatory Agreement. The new agreement intends to allow the creation of new regulations only

when agencies prove that they are needed because of an emergency, because of the need to comply with international commitments, or because of obligations established by law.

¶45. The federal law on administrative procedures has been a significant investment policy accomplishment. The law requires all regulatory agencies to prepare an impact statement for new regulations, which must include detailed information on the problem being addressed, the proposed solutions, the alternatives considered, and the quantitative and qualitative costs and benefits and any changes in the amount of paperwork businesses would face if a proposed regulation is to be implemented. Despite these measures, many difficulties remain. Foreign firms continue to list bureaucracy, slow government decision-making, lack of transparency, a heavy tax burden, and a rigid labor code among the principal negative factors inhibiting investment in Mexico. The Mexican government, with the OECD, the private sector and several think tanks, is currently working to implement a project to streamline bureaucracy and procedures.

¶46. The Secretariat of Public Administration has made considerable strides in improving transparency in government, including government contracting and involvement of the private sector in enhancing transparency and fighting corruption. The Mexican government has established several Internet sites to increase transparency of government processes and establish guidelines for the conduct of government officials. "Normateca" provides information on government regulations; "Compranet" allows for on-line federal government procurement; "Tramitanet" permits electronic processing of transactions within the bureaucracy thereby reducing the chances for bribes; and "Declaranet" allows for on-line filing of income taxes for federal employees.

Efficient Capital Markets and Portfolio Investment
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¶47. The Mexican banking sector has strengthened considerably since the 1994 Peso Crisis left it virtually insolvent. Since the crisis, Mexico has introduced reforms to buttress the banking system and to consolidate financial stability. These reforms include creating a more favorable economic and regulatory environment to foster banking sector growth by reforming bankruptcy and lending laws, moving pension fund administration to the private sector, and raising the maximum foreign bank participation allowance. The bankruptcy and lending reforms passed by Congress in 2000 and 2003 effectively made it easier for creditors to collect debts in cases of insolvency by creating Mexico's first effective legal framework for the granting of collateral. Pension reform allows employees to choose their own

pension plan. Allowing banks or their holding companies to manage these funds provides additional capital to the banking sector, while the increased competition focuses fund managers on investment returns. In December 2007, the Mexican Congress approved amendments to the Law of Credit Institutions (LIC) that include creating a new limited banking license and transferring power from Hacienda to the Banking and Securities Commission (CNBV), the primary banking regulator.

¶48. The financial profile of the banking sector has improved due to the reduction in the problem assets brought about by write-offs, problem loan sales, and the conclusion of most debt-relief programs. These developments, combined with more stringent capital requirements, have contributed to an improvement in the level and composition of capital across the banking system, particularly among the larger institutions.

¶49. The banking sector remains highly concentrated, with a handful of large banks controlling a significant market share, and the remainder comprised of regional players and niche banks. Hacienda has approved the opening of several new banks since 2006, including Wal-Mart Bank and Prudential Bank, but the sector's competitive dynamics and credit quality are still being driven by the six large banks-five of which are foreign owned. The newcomers are mostly focused on the unbanked population (D, E market segments) and will present only limited competition to the group of old banks.

¶50. Bank lending, especially consumer lending and mortgages, grew rapidly in 2005 and 2006, fueled by lower interest rates and historically low inflation. Small- and medium-sized businesses still complain of a lack of access to credit, but government-owned development banks have expanded their lending to this sector. Despite the expansion, such lending remains low as a percentage of GDP. Private banks argue that due diligence in lending to such business is difficult given the large amount of revenue they keep off the books to avoid increased tax liability.

¶51. Commercial loans to established companies with well-documented

accounts are available in Mexico, but many large companies utilize retained earnings to fund growth. Supplier credit is the main source of financing for many businesses. The largest companies are able to issue debt for their financing needs, tapping into a growing pool of pension funds looking for investment options. Non-bank financing is generally available, however, only to large companies with strong credit ratings and important commercial ties with their suppliers -- i.e., companies that could easily procure bank financing.

¶52. The Secretariat of Finance and Public Credit sets regulatory policy and oversees the CNBV. Mexico's central bank, the Bank of Mexico (BOM), also has a regulatory role in addition to setting monetary policy. The Institute for the Protection of Bank Savings (IPAB) handles deposit insurance.

¶53. Reforms creating better regulation and supervision of financial intermediaries and fostering greater competition have helped strengthen the financial sector and capital markets. These reforms, coupled with sound macroeconomic fundamentals, have created a positive environment for the financial sector and capital markets, which have responded accordingly.

¶54. The implementation of NAFTA opened the Mexican financial services market to U.S. and Canadian firms. Banking institutions from the U.S. and Canada have a strong market presence, holding approximately 70 percent of banking assets. Under NAFTA's national treatment guarantee, U.S. securities firms and investment funds, acting through local subsidiaries, have the right to engage in the full range of activities permitted in Mexico.

¶55. Foreign entities may freely invest in government securities. The Foreign Investment Law establishes, as a general rule, that foreign investors may hold 100 percent of the capital stock of any Mexican corporation or partnership, except in those few areas expressly subject to limitations under that law (Table I).

Regarding restricted activities, foreign investors may also purchase non-voting shares through mutual funds, trusts, offshore funds, and American Depositary Receipts. They also have the right to buy directly limited or non-voting shares as well as free subscription shares, or "B" shares, which carry voting rights. Foreigners may purchase an interest in "A" shares, which are normally reserved for Mexican citizens, through a neutral fund operated by a Mexican Development Bank. Finally, state and local governments, and other entities such as water district authorities, now issue peso-denominated bonds to finance infrastructure projects. These securities are rated by international credit rating agencies. This market is growing rapidly and represents an emerging opportunity for U.S. investors.

Political Violence

¶56. Potential investors should not find political violence a source of major concern. Peaceful mass demonstrations are common in the larger metropolitan areas such as Mexico City, Guadalajara, and Monterrey. Actual violence generally takes the form of local conflicts and inter-communal disputes and has occurred mostly in limited regions of Mexico's southern states. Since the initial January 1994 uprising of the Zapatista National Liberation Army (EZLN) in the state of Chiapas, government forces and the EZLN have clashed only once, although Chiapas has also experienced unrelated local violence. The Popular Revolutionary Army (EPR) and the Revolutionary Army of the People's Insurgency (ERPI) emerged in June 1996 and June 1998, respectively. They have carried out a number of small attacks, principally confined to the state of Guerrero.

¶57. In November 2006, the EPR claimed responsibility for three explosions in Mexico City, one of which damaged a branch of Scotia Bank. On two occasions in the summer of 2007, the EPR also claimed responsibility for bombings of PEMEX pipelines in the states of Guanajuato and Veracruz. While no injuries were reported, there was extensive property damage and temporary disruption to flows of oil and natural gas along damaged pipelines, negatively impacting up to 1000 businesses. Economic losses were reported to be in the hundreds of millions of dollars.

¶58. The last half of 2006 saw intense protests in the state of Oaxaca demanding, principally, the state governor's resignation. The capital city of Oaxaca was under siege by demonstrators for more than five months. Businesses -- particularly those in the tourist sector -- reported millions of dollars in losses and many Western countries, including the United States, issued travel warnings advising their citizens to avoid the area. At least 11 civilian deaths, including that of an American journalist, occurred as a direct result of the violence in Oaxaca and hundreds more were

injured and/or arrested. State police forces were accused of denying due process to protestors and using excessive force to break-up the demonstrations. In response to the escalating violence, the federal government sent the sent the Federal Protective Police to restore order. In 2008, Oaxaca remained calm for the most part and experienced only sporadic disturbances.

¶59. CRIMINAL AND NARCOTICS VIOLENCE: While political violence has been relatively minimal, narcotics and organized criminal violence has spiked over the past three years. As President Calderon continues a full-court press against the four major cartels operating in Mexico, kingpins have lashed back with violent acts unprecedented both in number and nature. 2008 set a new record for organized crime-related homicides with some 5,500 killings, more than double the previous record of approximately 2,500 reached in
¶2007. Violence has been endemic across the country, but particularly severe in cities bordering the United States. 48 percent of all killings took place in Chihuahua and Baja California states and were concentrated in large urban areas, presenting new challenges to the Mexican military and law enforcement's efforts to control violence. Cartel tactics evolved as well - victims were tortured or mutilated, and then left in public venues to intimidate others. Institutions including major media outlets and a U.S. Consulate have been subject to unprecedented attack. Moreover,

frustrated traffickers have turned to kidnappings and extortion to compensate for increased pressure from the Mexican government, targeting those innocent of any involvement in narcotics trafficking.

¶60. The United States is working with Mexico more closely than ever to combat organized crime and drug trafficking. The Merida Initiative was signed into law in June 2008 and will provide an initial $400 million dollars for Mexico. Funding in the first stage will provide, among other things, helicopters and surveillance aircraft, non-intrusive inspection equipment, technical advice and training to strengthen justice institutions to help bolster Mexico's interdiction, eradication, and administration of justice.

¶61. Though not political in nature, the Embassy has noticed that general security concerns remain an issue for companies looking to invest in the country. Many companies find it necessary to take extra precautions for the protection of their executives. They also report increasing security costs for shipments of goods. The Overseas Security Advisory Council (OSAC) monitors and reports on regional security for American businesses operating overseas. Eligible companies should become OSAC members. OSAC constituency is available to any American-owned, not-for-profit organization, or any enterprise incorporated in the U.S. (parent company, not subsidiaries or divisions) doing business overseas (https://www.osac.gov/).

¶62. The Department of State maintains a Travel Alert for U.S. citizens traveling and living in Mexico, available at: http://travel.state.gov/travel/ cis_pa_tw/pa/pa_3028.html.

Corruption

¶63. Corruption has been pervasive in almost all levels of Mexican government and society. President Calderon has stated that his government intends to continue the fight against corruption and government agencies at the federal, state and municipal levels are engaged in anti-corruption efforts. Aggressive investigations and operations have exposed corruption at the highest levels of government. In 2008, Calderon launched "Operacion Limpieza," investigating and imprisoning alleged corrupt government officials in enforcement agencies. The Secretariat of Public Administration has the lead on coordinating government anti-corruption policy.

¶64. Other government entities, such as the Superior Audit Office of the Federation (ASF, the equivalent of the GAO), have been playing a role in promoting sound financial management and accountable and transparent government with limited success as most Mexican external audit institutions (mostly at the state level) lack the operational and budgetary independence to protect their actions from the political interests of the legislators they serve.

¶65. Mexico ratified the OECD convention on combating bribery in May
¶1999. The Mexican Congress passed legislation implementing the convention that same month. The legislation includes provisions making it a criminal offense to bribe foreign officials. A bribe to a foreign official cannot be deducted from Mexican taxes. Mexico is also a party to the OAS Convention against Corruption and has signed and ratified the United Nations Convention against Corruption.

¶66. The government has enacted strict laws attacking corruption and

bribery, with average penalties of five to ten years in prison. A Federal Law for Transparency and Access to Public Government Information Act, the country's first freedom of information act, went into effect in June 2003 with the aim of increasing government accountability. Mexico's 31 states have passed similar freedom of information legislation that mirrors the federal law and meets international standards in this field. Five years after its passage, transparency in public administration at the federal level has noticeably improved, but access to information at the state and local level has been slow.

¶67. Mexico is ranked 72nd in international NGO Transparency

International's Corruption Perception Index for 2008, on par with China, India, and Brazil. The NGO's 2008 Bribe Payer's Index also named Mexican firms as some of the most likely to use bribes when doing business abroad. Local civil society organizations focused on fighting corruption are still developing in Mexico. The USAID-funded Project Atlatl has worked to coordinate and promote anti-corruption activities with Mexican civil society (www.atlatl.com.mx) and other key players in the anticorruption arena, such as federal and state audit institutions. The Mexican branch of Transparency International also operates in Mexico. The best source of Mexican government information on anti-corruption initiatives is the Secretariat of Public Administration (www.funcionpublica.gob.mx).

Bilateral Investment Agreements

¶68. NAFTA governs U.S. and Canadian investment in Mexico. In addition to NAFTA, most of Mexico's eleven other free trade agreements (FTAs) cover investment protection, with a notable exception being the Mexico-European Union FTA. The network of Mexico's FTAs containing investment clauses encompasses the countries of Bolivia, Chile, Costa Rica, Colombia, El Salvador, Guatemala, Honduras, Japan, and Nicaragua.

¶69. Mexico has enacted formal bilateral investment protection agreements with 24 countries: 14 European Union Countries (Austria, Belgium, Luxemburg, Denmark, Finland, France, Germany, Greece, Italy, Netherlands, Portugal, Spain, Sweden, United Kingdom), as well as Australia, Argentina, Cuba, Iceland, India, Panama, South Korea, Switzerland, Trinidad and Tobago, and Uruguay. Agreements with China, Belarus and Slovakia were signed in 2007 and 2008, but the Senate still has to ratify them. Mexico continues to negotiate bilateral investment treaties with Russia, Saudi Arabia, Malaysia, Singapore, and the Dominican Republic.

¶70. The United States and Mexico have a bilateral tax treaty to avoid double taxation and prevent tax evasion. Important provisions of the treaty establish ceilings for Mexican withholding taxes on interest payments and U.S. withholding taxes on dividend payments. The implementation of the IETU on January 1, 2008 has led to questions as to whether the new tax meets the requirements of the bilateral tax treaty. The U.S. Internal Revenue Service presently allows businesses to credit the IETU against their U.S. taxes. However, businesses should continue to monitor this issue.

¶71. Mexico and the United States also have a tax information exchange agreement to assist the two countries in enforcing their tax laws. The Financial Information Exchange Agreement (FIEA) was enacted in 1995, pursuant to the Mutual Legal Assistance Treaty. The agreements cover information that may affect the determination, assessment, and collection of taxes, and investigation and prosecution of tax crimes. The FIEA permits the exchange of information with respect to large value or suspicious currency transactions to combat illegal activities, particularly money laundering. Mexico is a member of the financial action task force (FATF) of the OECD and has made progress in strengthening its financial system through specific anti-money-laundering legislation enacted in 2000 and 2004.

OPIC and Other Investment Insurance Programs

¶72. In August of 2004, Mexico and the U.S. Overseas Private Investment Corporation (OPIC) finalized an agreement that enables OPIC to offer all its programs and services in the country. Since then, OPIC has aggressively pursued potential investment projects in Mexico, and the country rapidly became one of the top destinations for projects with OPIC support. As of September, 2008, OPIC was actively providing over $730 million in financing and political risk insurance support to 17 projects in Mexico.

¶73. In addition, OPIC-supported funds are among the largest providers of private equity capital to emerging markets. Since 1994, OPIC has committed (as of FY2008) almost 3.2 billion USD in

funding to 43 private equity funds. The OPIC funds which are currently investing in Mexico include Alsis Latin America Fund, Darby-BBVA Latin America Private Equity Fund, Darby ProBanco II Fund, Latin Power Trust III, and Paladin Realty Latin America Investors II. For a more detailed description of these funds including fund contact information and investment strategy, please consult OPIC's website at www.opic.gov.

Labor

¶74. Mexico's Federal Labor Law, enacted in 1931 and revised in 1970, is based on article 123 of the Mexican constitution. Under the law, Mexican workers enjoy the rights to associate, collectively bargain, and strike. The law sets a standard six-day workweek with one paid day off. For overtime, workers must be paid twice their normal rate and three times the hourly rate for overtime exceeding nine hours per week. Employees are entitled to most holidays, paid vacation (after one year of service), vacation bonuses, and an annual bonus equivalent to at least two weeks pay. Companies are also responsible for these additional costs. These costs usually add about 30 to 35 percent to the average employees' salary. Employers must also contribute a tax-deductible two percent of each employee's salary into an individual retirement account. Most employers are required to distribute ten percent of their pre-tax profits for profit sharing. Speaking on behalf of the current administration, the Labor Secretary has repeatedly affirmed that labor reform is and remains one of the top priorities of President Calderon's government.

¶75. There is a large surplus of labor in the formal economy, largely composed of low-skilled or unskilled workers. On the other hand, there is a shortage of technically skilled workers and engineers. Labor-management relations are uneven, depending upon the unions holding contracts and the industry concerned. Mexican manufacturing operations are experiencing stiff wage competition from Central America, China, India, and elsewhere in low technology work, such as textile and garment manufacture.

¶76. For the past few years, with the possible exception of the mining industry, strikes have been limited and usually settled quickly. Strikes that are more difficult will usually draw government mediators to help the settlement process. Independent unions have been playing an increasingly significant role, particularly since the formation of the new Labor Federation (National Union of Workers) in November 1997. Information on unions registered with federal labor authorities is supposed to be available to the public via Internet (www.stps.gob.mx), but this database is incomplete.

Foreign Trade Zones/Free Ports

¶77. In addition to the IMMEX programs that operate as quasi-free trade zones, in 2002 Mexico approved the operation of more traditional free trade zones (FTZ). Unlike the previous "bonded" areas that only allowed for warehousing of product for short periods, the new FTZ regime allows for manufacturing, repair, distribution, and sale of merchandise. There is no export requirement for companies operating within the zone to avail themselves of tax benefits. Regulatory guidance for the new regime is still being amended; therefore investors should consult a tax lawyer for detailed information. Most major ports in Mexico have bonded areas ("recinto fiscalizados") or customs agents ("recintos fiscal") within them. There are currently two approved FTZ's, both operating in San Luis Potosi. The first major plant in the FTZ is currently under construction. Several states have filed to convert their bonded areas into Free Trade Zones.

Foreign Direct Investment Statistics

¶78. Foreign Direct Investment in Mexico (USD Million)
2003 2004 2005 2006 2007
Total FDI
Inflow:
18,249 25,578 24, 756 21,632 29, 046(G)
New Investments

	2003	2004	2005	2006	2007
	7,070	14,003	11,823	5,332	13,011
Earnings Reinvestment	2,082	2,489	3,883	7,693	8,022
Inter-company Investment	7,094	7,082	7,045	6,602	6,006

¶79. Foreign Direct Investment Realized in Mexico By Industrial Sector Destination (USD Million)

	2003	2004	2005	2006	2007
Total FDI Inflow:	18,249	25,578	24,756	21,632	29,046
Agriculture	12	22	10	22	132
Extractive	90	174	203	367	1,919
Manufacturing	7,594	13,127	11,934	9,785	12,020
Electricity and Water	326	202	202	(87)	164
Construction	81	389	280	357	1,732
Retail	1,453	1,268	2,805	579	1,453
Transport and Communication	2,198	1,658	2,869	633	800
Financial Services	2,910	5,737	1,605	5,340	6,606
Others	1,587	999	2,844	2,630	2,213

¶80. Foreign Direct Investment Inflows Realized By Country/Economy of Origin (USD Million)

	2003	2004	2005	2006	2007	5yr Totals
Total FDI Inflow:	18,249	8,538	24,756	21,632	29,046	119,260
United States	9,120	8,538	11,595	12,958	11,276	53,487
Spain	2,857	7,854	2,126	1,462	5,182	19,481
Holland	711	3,340	2,437	2,695	4,318	13,501
France	532	226	364	118	203	1,443
United Kingdom	1,074	274	1,283	1,232	580	4,443
Virgin Islands	(6)	56	2,051	292	1,093	3,492
Canada	259	531	425	557	819	2,591
Switzerland	286	1,135	313	565	584	2,883
Germany	466	408	341	207	477	1,899
Argentina	3	10	541	22	22	598
South Korea	57	48	96	71	40	312
Brazil	19	48	49	50	21	187
Taiwan	10	10	24	22	8	74
China	26	12	5	4	8	55
Japan	122	370	119	(1460)	372	(487)

Notes FDI Investment Charts:
A) Sources: Inflow - Mexican Secretariat of Economy, Director General of Foreign Investment.
B) Period: 2007 data (January through December)
C) Data: Millions of U.S. Dollars (USD), unless noted.
D) The Secretariat of Economy has recalculated values for past years. All values for past years are the most up to date data provided by the Secretariat of Economy.

E) With the passage of the IMMEX law integrating Maquila and Pitex industries, "Maquiladora Investment in Fixed Assets" is no longer reported separately and is included in the category "Inter-company Investments".
F) Yearly amounts may differ from 5 year totals due to rounding error.
G) The total FDI inflow for 2006 and 2007 by type of investment is less than the total FDI in Mexico because it does not include an estimate that has been reported in the total FDI.

¶81. FDI Inflow as a Percentage of GDP

	2003	2004	2005	2006	2007
GDP	639,100	683,500	767,700	840,000	893,000
FDI Inflow	16,589	22,777	20,960	19,212	27,000
Percent of GDP	2.6	3.3	2.7	2.3	3.0

Notes on "FDI as a Percentage of GDP" chart:
A) GDP figures are taken from the Mexican Statistics Agency, INEGI.

Figures in millions of dollars at current market prices.

¶82. U.S. FDI Flow and Stock in Mexico (USD Millions)

	2004	2005	2006	2007
U.S. FDI Flow in Mexico	8,435	9,596	8,777	8,815
U.S. FDI Stock in Mexico	63,384	73,687	83,219	91,663

Notes U.S. FDI Flow and stock in Mexico chart:
A) Source: U.S. Department of Commerce Bureau of Economic Analysis.

¶83. Mexico FDI Flow and Stock in U.S. (USD Millions)

	2004	2005	2006	2007
Mexico FDI Flow in U.S.	(629)	(19)	1886	63
Mexico FDI Stock in U.S.	7,592	3,595	5,332	5,954

Notes U.S. FDI Flow and stock in Mexico chart:
A) Source: U.S. Department of Commerce Bureau of Economic Analysis.

¶84. In 2008 the U.S. and other nations' companies announced several large investments, including:

A) Goldcorp (a Canadian mining company), USD 1.5 billion in Zacatecas
B) General Motors, USD 900 million in Ramos Arizpe, Coahuila
C) Ford, USD 3 billion in Cuautitlan, Chihuahua, and Guanajuato
D) Bombardier, USD 250 million in Queretaro
E) Q-Cells (a German photovoltaics company), USD 3.5 billion in Mexicali, Baja California
F) Goodrich, USD 92.5 million for an aeroparts plant in Baja California

¶85. Web Resources

ProMexico: http://www.investinmexico.com.mx
Federal Competition Commission: www.cfc.gob.mx
National Infrastructure Plan: www.infraestructura.gob.mx
Department of State Legal Advisory: www.state.gov/s/l
Nacional Financiera Development Bank: www.nafin.com
Sec. of Economy's IMMEX Program: http://www.economia.gob.mx/?P=2297
WIPO: http://www.wipo.int/about-ip/ en/ipworldwide/pdf/mx.pdf
Secretariat of Public Administration: www.sfp.gob.mx
Overseas Private Investment Corporation: www.opic.gov

BASSETT

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